84-450

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.,
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

JURISDICTIONAL STATEMENT

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September 21, 1984

QUESTIONS PRESENTED BY THE APPEALS

1. Are the requirements of the Fifth Amendment satisfied by a just compensation award, entered in 1984 with respect to a 1976 taking, providing for the delivery of a Government debt obligation, rather than cash, in an amount equal to the valuation of the property taken, payable by December 31, 1987; and, if so, is not the interest rate accruing on the debt obligation of 8%, compounded annually from the date of the taking, constitutionally inadequate since (a) it causes the fair market value of the obligation at the time of its delivery to be 15% less than its face value and (b) it fails to compensate the condemnee for the loss of much greater yields generally available during the period of delay on conservative debt securities?

2. Are the just compensation requirements of the Fifth Amendment satisfied when the Government takes for continued rail use an operating rail system that has been incurring losses and pays an amount measured solely by a scrap valuation of the assets which assesses penalties for the rail use values transferred and takes various sales, title and other liquidation deductions inconsistent with federal condemnation law?

3. If such discounted scrap values can provide just compensation, should they be determined with reference to actual markets existing at the date of the taking and contemporaneous assessments of such values by potential purchasers or should they be determined in the abstract by a judicial modeling of the scrap values realizable in hypothetical markets presumed to be glutted by the rail properties of other railroads simultaneously taken by the Government in the same project?

4. Did the valuation methodologies adopted by the Court below create undue risk of, and in fact lead to, speculative and arbitrary determinations?

5. Is a railroad entitled to severance damages measured by the costs of removal of its bridge over navigable waters where the rail property surrounding the bridge has been taken, rendering the bridge useless and outside the scope of the Truman-Hobbs Act, 33 U.S.C. § 501 *et seq.*, and obliging the railroad to remove it at its own cost as a navigational hazard?

THE PARTIES BELOW

The parties to the proceeding at the time of the entry of the judgment appealed from were:

1. the CNJ parties consisting of the following related companies each of whom is an appellant here, collectively referred to as "CNJ" or the "CNJ Appellants":
   a. The Central Railroad Company of New Jersey, now, as reorganized, Central Jersey Industries, Inc.*
   b. Dover & Rockaway Railroad Co.
   c. Mt. Hope Mineral Railroad Co.
   d. Wharton & Northern Railroad Co.
   e. Central Railroad Co. of Pennsylvania
   f. Communipaw Central Land Co.
   g. Bay Shore Connecting Railroad.
2. the Government Parties consisting of:
   a. United States Railway Association (USRA)
   b. United States Department of Transportation (USDOT)
   c. United States of America
   d. Consolidated Rail Corporation (Conrail)

The proceedings initially had numerous other parties whose participation has ceased as a result of settlements and other transactions.

* Central Jersey Industries, Inc. is the parent company of the other Appellants. There are no other subsidiaries or affiliates of any of the Appellants other than wholly owned subsidiaries. This jurisdictional statement is filed on behalf of all Appellants.

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CENTRAL JERSEY INDUSTRIES, INC., a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

JURISDICTIONAL STATEMENT

THE OPINIONS BELOW

The final judgment appealed from arises out of determinations made in the course of a number of opinions rendered by the Special Court in *In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act of 1973*, a proceeding to set the compensation payable to various Northeastern railroads in reorganization for compelled transfers of their assets to Conrail and others. The pertinent determinations appear in the opinion at 425 F. Supp. 266 outlining procedures to be followed and issues to be addressed (CA-30)[1]; the opinion at 439 F. Supp. 1351 concerning the issue of compensable unconstitutional erosion (CUE Opinion) (CA-77); the opinion at 445 F. Supp. 994 concerning principles to govern the determination of net liquidation values and constitutional minimum values under the Rail Act (CMV Opinion) (CA-160); the opinion at 531 F. Supp. 1191 concerning certain valuations and determinations as to continued rail use (Rail Use Opinion)

1. The references to the Appendix volumes hereto have been designated as (CA-xxx).

(CA-266); the opinion at 571 F. Supp. 1269 concerning the nonrail use valuation of CNJ's transferred assets (CNJ Opinion) (CA-677); the opinion deciding petitions for reconsideration of the CNJ Opinion *id.* at 1335 (CA-792); the unreported opinion resolving remaining disputes as to the implementation of the principles set forth in the CNJ Opinion (CA-807); and the unreported opinion disposing of CNJ's claim for severance damages and its claim for delay damages over and above the interest provided by the statute (Severance/Delay Damage Opinion) (CA-815).

THE GROUNDS OF THE SUPREME COURT'S JURISDICTION

These appeals are from the final judgment of the Special Court issued under § 303(c) of the Regional Rail Reorganization Act of 1973, as amended (the Rail Act), 45 U.S.C. § 743(c) entered on July 23, 1984. The CNJ parties filed their notices of appeal to this Court in the Special Court on July 30, 1984. Jurisdiction of these appeals are conferred upon this Court by § 303(d) of the Rail Act, 45 U.S.C. § 743(d).

CONSTITUTIONAL PROVISIONS AND STATUTES

Fifth Amendment, United States Constitution:

> ... nor shall private property be taken for public use, without just compensation.

Statutes: § 303(c)(d) of the Rail Act, 45 U.S.C. § 743(c)(d), and § 306 of the Rail Act, 45 U.S.C. § 746.[2]

STATEMENT OF THE CASE

These appeals arise out of the valuation proceeding conducted by the Special Court (i) under § 306 of the Rail Act, 45 U.S.C.

2. The texts of the cited statutory provisions are contained in Appendix Q. (CA-884 *et seq.*)

§ 746, determining the net liquidation value and other components of the certificates of values to be issued by USRA as compensation to various transferors who conveyed rail properties to Conrail and others and (ii) under § 303(c) of the Rail Act, 45 U.S.C. § 743(c), determining whether the terms of the mandated exchanges satisfy constitutionally minimum standards. The constitutionality of the Rail Act in its initial form was sustained by this Court in the *Rail Act Cases*, 419 U.S. 102 (1974); and the reorganization of CNJ and other transferors under its terms was required by the Special Court in *In the Matter of Penn Central Transportation Co., et al.*, 384 F. Supp. 895 (Regional Rail Reorg. Ct. 1974).[3]

On April 1, 1976 most of the rail assets of CNJ and of the other transferors were transferred to Conrail pursuant to the order entered by the Special Court under § 303(b) of the Rail Act, 45 U.S.C. § 743(b). The valuation proceeding commenced about that time and initially addressed the compensation to be provided for the assets of all transferors. As a result of various settlements the claims of the present appellants are the only claims that remain outstanding under § 303(c), 45 U.S.C. § 743(c).

At the time of the conveyances, CNJ was a Class I railroad based in the northern New Jersey metropolitan area with lines extending to the western and southern borders of the State. CNJ originated and terminated important freight traffic, particularly that moving to and from the concentrated industrial area extending from Newark to the Amboys, known as the "Chemical

3. These initial cases concluded that the Rail Act was a valid reorganization statute enacted pursuant to the bankruptcy power. At that time, the anticipated compensation for the asset transfer was principally the securities of Conrail, the reorganized railroad contemplated by the Rail Act. A subsequent amendment added certificates of value to the compensation package, guaranteeing certain recoveries on the Conrail securities; 45 U.S.C. § 746, added by Pub. L. 94-210, Title VI, § 610(b), 90 Stat. 104 (1976), but a later amendment withdrew the Conrail securities from the compensation. 45 U.S.C. § 1115, added by Pub. L. 97-35, Title XI, § 1167(b), 95 Stat. 686 (1981). The government conceded, during the course of the proceedings below, that the adequacy of the compensation is to be measured by the standards governing the taking clause of the Fifth Amendment. *CMV Opinion*, 445 F. Supp. at 1000 (CA-168-69).

Coast". The freight services performed by CNJ were found to be essential by both the Secretary of the USDOT acting pursuant to the Emergency Rail Services Act, 45 U.S.C. § 601 and New Jersey transportation officials. *Rail Use Opinion,* 531 F. Supp. at 1379 (CA-578). CNJ also provided extensive commutation services within the State of New Jersey under subsidy arrangements which CNJ considered confiscatory.

CNJ had been in reorganization under § 77 of the Bankruptcy Act, former 11 U.S.C. § 205, since March of 1967 and had incurred operating losses for many years. In 1971 it undertook a broad revitalization program to restructure freight operations and to improve commuter subsidy arrangements. There was progress in restructuring the freight operations, *see Central R. Co. of New Jersey—Abandonment,* 342 I.C.C. 227 (1972) and *Routing via Oak Island Junction,* 341 I.C.C. 129 (1972); but CNJ's efforts to place its passenger operations on a compensable basis which, it believed would permit an income based reorganization, were impeded by the decision in *In the Matter of The Central Railroad Company,* 485 F.2d 208 (3d Cir. 1973), *cert. denied sub nom. Timpany* v. *New Jersey,* 414 U.S. 1131 (1974).[4]

The Rail Act became law on January 2, 1974. CNJ, as the Special Court has noted, opposed both the passage of the Act, *CUE Opinion,* 439 F. Supp. at 1379 n.45 (CA-114, 149), and its reorganization thereunder, *In the Matter of Penn Central Transportation Co.,* 384 F. Supp. at 951 n.115, even with the availability of the Tucker Act to remedy any "shortfall" in compensation. *Rail Act Cases,* 419 U.S. at 125-48. CNJ was concerned that the Rail Act required it to trade known acceptable alternatives for the greater uncertainties of a delayed judicial assessment of their value. This concern was borne out by subsequent events.

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4. The Third Circuit held, *en banc,* that the CNJ Reorganization Court lacked the power to enter an order that might have led to the cessation of passenger operations because the estate's progress in the reorganization precluded a finding that continued operations threatened an unconstitutional taking. 485 F.2d at 215-16. Congress subsequently provided such power to reorganization courts in the railroad reorganization provisions of the Bankruptcy Code. *See* 11 U.S.C. § 1170.

Prior to Congress's active consideration of the Rail Act, CNJ's preferred alternative was to continue operating under a program that sought improved passenger subsidies, rail consolidations and the positioning of CNJ as a neutral terminal company in New Jersey prepared to take over the traffic of other railroads which were seeking to withdraw.[5] After passage of the Rail Act, CNJ's reorganization effort evolved toward a potential sale of its rail system to the State of New Jersey. CNJ had been exploring with the State since 1971 the possibility of changing its avoidable cost subsidy contract into a full cost of service passenger contract with provision for a return on its investment in the facilities used in passenger service. In early 1974 these discussions were expanded to include the consideration of a purchase by the State of all of CNJ's New Jersey rail facilities. By the summer of 1974 the Commissioner of Transportation had been engaged for more than six months in serious discussions of this subject with various representatives of bondholders, the Trustee, the reorganization judge, and key federal officials at USDOT, UMTA and USRA. The NJDOT had agreed to major improvements in passenger subsidy arrangements and to provide substantial funds for main-line rehabilitation. These and other favorable developments led the reorganization court on July 15, 1974 to state at a hearing:

> I have a very, very strong feeling, based on my knowledge of the case from its beginning, that the flame at the end of the tunnel is brighter than it ever was before.[6]

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5. The Court stated in the *CUE Opinion*, 439 F. Supp. at 1382 (CA-119) "The Trustee has made a rather impressive showing that Congress' consideration and enactment of the Rail Act had a particularly negative effect on the CNJ" noting, as well, that the Act had brought to a halt important negotiations with other railroads for acquisition of its facilities. *Id.* at n.55 (CA-118, 151).

6. The reorganization court's intimate knowledge of the underlying asset values of the estate, as well as of its progress and alternatives, had previously led it to reject various efforts by creditors to obtain cessation of railroad operations and dismiss the proceedings. See oral opinions of the Honorable Anthony T. Augelli, *In the Matter of The Central Railroad Company of New Jersey*, No. B 401-67 (D.N.J.) of Mar. 26, 1971 and Dec. 8, 1972 (CA-912, 923).

In the Matter of the Central Railroad Company of New Jersey, No. B 401-67, Hearing Record at 15 (D.N.J. July 15, 1974) (Augelli, J.). By the end of July, 1974, the negotiations over the sales price had narrowed to the range of $80 to $105 million.[7]

At the time of these discussions, the State had available to it an extensive scrap study prepared by Wyer, Dick & Co. for the CNJ estate, finding a scrap value for CNJ's assets at June 30, 1968 of $79,600,000,[8] and a detailed analysis of that study prepared by DeLeuw Cather & Co. for the State of New Jersey in 1971 which concluded that CNJ's scrap value as of June 30, 1968 was approximately $91,500,000. The Commissioner decided to update these studies in connection with the negotiations; and in late July of 1974, the State retained L. E. Peabody & Associates to perform a further study and directed that James Hyde, the Director of the Rights of Way Division of the New Jersey DOT also perform an additional independent valuation. These studies were completed by the end of the summer; and each contained valuations based upon various methodologies, including scrap. The scrap value found by L. E. Peabody & Associates was $112,981,000; and the Rights of Way Division found a scrap value of $121,000,000 for just the real estate and track materials. However, the negotiations for the purchase of the CNJ came to an end when the Special Court issued its opinion under § 207(b)

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7. In its *Rail Use Opinion*, 531 F. Supp. at 1377 n.339 (CA-577, 657), the Special Court expanded the range of prices beyond that actually under consideration by including prices referred to in various valuation studies. The range in the actual negotiations was significantly narrower, both parties accepting the concept that the State would pay all debts superior to the CNJ's outstanding bonds with something "on top" for the bonds. The CNJ trustee quantified these debts as $80 million and proposed an additional payment of $25 million. The State's own internal memoranda suggested the Commissioner's willingness to pay an additional $10-15 million.

8. Wyer, Dick & Co. stressed in its study that the net liquidation values shown were hypothetical values based upon unrealistic assumptions that the railroad would be dismantled and its patrons denied service. It opined that higher values would be obtained if certain of the CNJ lines would be sold in place for continued rail use; and it pointed out that scrap prices had risen substantially from the June 30, 1968 "as of date of study". The analysis prepared by DeLeuw Cather & Co. for the State of New Jersey confirmed those observations.

of the Rail Act, 45 U.S.C. 717(b) holding that, subject to the outcome of the *Connecticut General* case,[9] CNJ and the other railroads in reorganization in the Northeast would be reorganized under the Rail Act. *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 984.

On April 1, 1976 CNJ, pursuant to the § 303(b) order of the Special Court, conveyed almost all of its rail system to Conrail. This included approximately 700 miles of track, 3,400 acres of real estate, all of its rolling stock, equipment, and other rail assets.[10] Excepted from the conveyance was a major structure, the Newark Bay Bridge, which linked CNJ's rail facilities on the Bayonne peninsula with its rail facilities in Elizabeth—though the right of way to the west of the Bridge in Elizabeth and to the east of the Bridge in Bayonne was conveyed and Conrail was given an easement over the Bridge for as long as it utilized the Bridge in providing commuter service to Bayonne. The commuter service was terminated in 1978; and the Coast Guard then notified CNJ of its intention to issue an order directing CNJ as the owner of the Bridge to remove it under the Bridge Act of 1906, 33 U.S.C. § 494, at a cost estimated by the government to be approximately $14 million.[11]

In September of 1979 CNJ consummated a plan of reorganization disposing of more than $160 million in creditor claims. *In the Matter of The Central Railroad Company of New Jersey*, 473 F. Supp. 225 (D.N.J. 1979). Most of the creditors, including its largest, the United States, were given various interests, according to established priorities, in such proceeds as would ultimately be derived from the valuation case.

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9. *Connecticut Gen. Ins. Corp.* v. *United States Ry. Ass'n*, 383 F. Supp. 510 (E.D. Pa.), *rev'd sub nom Regional Rail Reorganization Cases*, 419 U.S. 102 (1974).

10. The State of New Jersey thereafter purchased from Conrail substantial portions of CNJ's lines.

11. In prior years the Coast Guard had determined that the Bridge constituted a hazard to navigation and had offered to alter it pursuant to the Truman-Hobbs Act, 33 U.S.C. § 501 *et seq.*, under which the United States would have paid substantially all of the alteration costs. *Severance/Delay Damage Opinion, slip op.* at 29 (CA 838).

The litigation of the valuation case proceeded in four stages: (1) the briefing, argument, and determination of various legal issues—principally the statutory and constitutional principles to govern a trial of the compensation to be paid; (2) a trial of the rail use issues—identifying the rail assets which would be sold for rail use if, hypothetically, all transferors sought to dispose of all their rail assets at the same time, and, to the extent feasible, arriving at a sales price; (3) a trial of the scrap value of CNJ's conveyed assets; and (4) a trial of CNJ's claims to be compensated for severance damages to the Newark Bay Bridge and for delay damages in excess of the 8% compounded interest accruing on the certificates of value to be issued under Section 306 of the Rail Act, 45 U.S.C. § 746. None of the trials were conducted in the presence of the Court. Instead, each proceeded by the submission of written testimony, followed by discovery and/or cross examination upon deposition, with a subsequent designation of a record, briefing, argument, and decision.

The final result of the entire process was the entry of a judgment fixing the net liquidation value of the assets conveyed by CNJ and certain of its affiliates at approximately $42.5 million with direction to USRA to deliver certificates of value in that amount bearing interest at the rate of 8% compounded annually from the date of the taking on April 1, 1976 to the date of their redemption which is to occur not later than December 31, 1987.[12] The Special Court rejected CNJ's contentions that its net liquidation value under Section 306 was higher, that such value was less

12. Section 306(c) of the Rail Act requires a determination of the base value of the certificates of value to be issued thereunder by USRA. The essential elements of such base value are: (i) the net liquidation value of the assets transferred; (ii) a reduction for the value of other benefits received by the transferor under the Rail Act; (iii) an addition for the amount of compensable unconstitutional erosion to which the transferor was entitled; and (iv) an addition of interest from the transfer date to the redemption date at the rate of 8% per annum, compounded annually. The parties stipulated that the value of other benefits and the amount of compensable unconstitutional erosion were zero. The Court found the net liquidation value to be $42.5 million and the interest accrued thereon at the statutory rate approximates $37.5 million at June 30, 1984.

than the constitutional minimum required to be paid under Section 303(c), and that, under Section 303(c), it was entitled to additional delay and severance damages.

In arriving at the net liquidation value of $42.5 million, the Special Court constructed a liquidation model under which the transferred assets were assumed to be dismantled and sold over an eight-year period. It was assumed that rolling stock, ties, rail and other track materials would be disposed of in markets glutted by assets of other transferors who were presumed to be going through a similar scrapping process. These assumptions increased available supply competing with CNJ's dismantled assets and decreased demand for such assets by eliminating the other transferors as potential purchasers—leading to the hypothetical conclusion that large volumes of CNJ's rail and other track material, ties and rolling stock used in providing rail service at the time of the taking and thereafter should be classified as suitable only for scrap or worthless, rather than as reusable material, and to a reduction in prevailing unit prices for many of such assets. We estimate that projected disposition proceeds were reduced by as much as $10 million as a result of this glutted market assumption. Moreover, no values were allowed for various improvements to the properties, made at a cost of many millions of dollars, such as grading, fill, ballast, and structures useful only for rail purposes; and nothing was included for either the costs or the value of the assemblage of the extensive real estate parcels into an inter-connected system of rights-of-way and yards. Instead, penalties were generally imposed because of the existence of such improvements which were essential to the use and transfer of a going railroad. Real estate appraisals were reduced by the costs of removing buildings useful only for rail purposes and the costs of bringing the land to a level state; and such appraisals were further reduced by a variety of costs presumed to be incurred in disposing of the real estate parcel by parcel over a projected eight-year disposition period.

Large deductions were taken from the projected sales proceeds for hypothetical disposition and overhead costs and to account for

delays in realization. $5.4 million was deducted for the costs of dismantling the track facilities; $2.1 million was deducted for the costs of a liquidation organization; $1.1 million was deducted for delay in disposing of the non-real estate assets; and the fair market value of the real estate at April 1, 1976 ($34.2 million as found by the Court) was reduced by $14.2 million. The components of the $14.2 million in real estate costs include a reduction of 7% from appraised values for reversionary title (presumed to come into effect with the cessation of rail use); a reduction of 10% of projected sales proceeds, principally for taxes and other net holding costs presumed to be incurred over an eight-year disposition period; and a net yearly reduction of 12.22% of projected sales proceeds to present value those proceeds from the date of their projected receipt back to the taking date of April 1, 1976.[13] These reductions from real estate values were made notwithstanding clear evidence that the real estate appraisals had already taken into consideration contemplated future taxes and other holding costs, delays and difficulties in disposition,[14] and probable appreciation over time.

Most of the proceedings below were devoted to a trial of the net liquidation value of the assets transferred required by § 306(c).[15] The Court had held that the statutory meaning of "net liquidation value" embraced dispositions for any use (and not just for junk), *CMV Opinion*, 445 F. Supp. at 1004 (CA-177), and concluded

13. Appraisal values were appreciated by 3% per year; but annual projected proceeds were discounted by 15.22% per year to present value their worth to April 1, 1976. The Court made no adjustment for earnings on the sales proceeds that would have been realized; and since interest on the ultimate recovery was limited to 8%, a significant loss in value has been the result.

14. For example, the appraisals attributed no value at all to many right-of-way parcels and discounted the value of other parcels by as much as 95% of prevailing "across the fence" values for normal acreage in the relevant areas.

15. Since Section 306 required that each transferor prove its own net liquidation value, the Second and Sixth Pretrial Orders directed all transferors to prove what their properties would bring on the assumption that each would seek to dispose of all of their assets for continued rail use or for scrap. The assumption, though unrealistic, drove the resulting values down since they led to glutted market conditions for both types of sales.

that the transferors should prove the value of their transferred assets in assumed dispositions for continued rail use and for scrap. *Id.* at 1008-10 (CA-185-90). The Court noted, in discussing the problems facing the transferors in proving rail use sales, that the Government had been well-advised in conceding "that it would not demand proof that the transferors had received actual offers at identifiable prices", *id.* at 1008 (CA-185), and that "the Government Parties might be well advised not to be overly finical in their attitude toward such proof." *Id.* at 1030 (CA-227).[16]

In its opinion disposing of the rail use issues, the Court reviewed the evidence of New Jersey's negotiations for the purchase of the CNJ and concluded:

> Three days later negotiations effectively stopped when this Court decided that CNJ should be reorganized under the Act, *180-Day Appeals*, 384 F. Supp. at 954-55, 987-89.
>
> This train of events substantiates CNJ's assertion that, up until that decision, New Jersey had shown great and increasing interest in purchasing CNJ. Despite this, *it is far from certain* that the State would have actually carried out such a project. On the contrary, neither Sagner nor any one else in State government was ready to make any final decision on the matter. (emphasis added).
>
> *****
>
> In short, although the record suggests that Sagner pursued and probably favored a State purchase, it does not bear out the allegation that New Jersey was on the verge of buying CNJ's entire system. On the contrary, we cannot conclude with any confidence that any State purchase

16. Despite these views, the Second Pretrial Order, establishing the framework for a trial of rail use values, emphasized the desirability of the transferors coming "as close as possible" to the goal of joining "in a single scenario describing a particular purchaser for each route segment" and adopted the Government's proposal "for a single trial encompassing all rail uses" of all transferors. (CA-902, 904) The issue of whether such a disposition process would ever have occurred was never set for trial as the Government repeatedly contended that what actually would have occurred was unknowable and immaterial. *Rail Use Opinion*, 531 F. Supp. at 1211-12 (CA-295-96).

> would have occurred at all. There are simply too many unknowns, too many decisions not yet made, too many important actors still absent from the stage, to permit that.

Rail Use Opinion, 531 F. Supp. at 1377-78 (CA-575-77). Having rejected the evidence of CNJ's actual sales negotiations with the State of New Jersey as a basis for determining the disposition value of CNJ's rail system for continued rail use, the Court nevertheless, concluded that, if the Rail Act had never been enacted and if all the railroads in reorganization in the Northeast had sought to dispose of their properties at the same time, all of CNJ's rail assets would have been acquired for continued rail use by the State of New Jersey, *id.* at 1379 (CA-578-79), on or about April 1, 1976 pursuant to an agreement negotiated in late 1973 with the properties valued as of January 1, 1974. *Id.* at 1311 (CA-466). The Court further concluded that the price paid would have been set with reference to some variant of scrap value, called X and left the determination of X to the next phase of the case. *Id.* at 1382-83 (CA-584).

The Sixth Pretrial Order governed the trial of the scrap value issue. The *Rail Use Opinion* had indicated that the value perceptions of the potential purchaser were significant:

> What counts [in a single bidder situation] is what the buyer would have perceived the seller's likely receipts from dismantling or condemnation to be.

Id. at 1220 (CA-310).

> These beliefs are important in predicting public body actions in the alternative scenario because prices can only be based upon X as perceived by the parties to the negotiations, and not upon some other figure determined by hindsight.

Id. at 1329 (CA-495-96); and the Sixth Pretrial Order directed the parties to submit:

> the balance of their direct cases not later than December 1, 1981 (including with regard to lines kept in rail use but

> sold for a price based on non-rail use values, any adjustments for the perceptions of the parties negotiating or otherwise setting the sale price).

(CA-909). On the perceptions issue, CNJ relied heavily on the three scrap value studies, referred to above at page 6, that the State had commissioned—the DeLeuw Cather study and the studies prepared by L. E. Peabody and the Rights of Way Division in connection with the 1974 purchase negotiations. CNJ submitted detailed testimony of expert witnesses which specifically identified the values assigned in such studies to the assets transferred to Conrail and independently priced the small amount of new assets which CNJ had acquired subsequent to 1974 and conveyed to Conrail. This testimony concluded, after certain proposed reconciliations of differences between the studies, that the State of New Jersey perceived the 1974 net scrap value of CNJ's transferred assets as approximately $72.8 million.[17]

The Special Court in the *CNJ Opinion* rejected this historical evidence as to how the State would have perceived CNJ's scrap values stating:

> We are left with two conflicting impressions. One is that, on the basis of the appraisals, Sagner would have returned to the bargaining table with an offer which exceeded not only the GP's presently asserted scrap value figure [$23 million] but the higher scrap value figure we have found. [$42.5 million] For one reason or another the minds of all concerned in 1974 were attuned to a higher scale. There is, for example, no evidence that in 1974 New Jersey entertained such ideas as that all of CNJ's ties and much of its rail was valueless, largely because of glut, although perhaps it ought to have done so. The other impression is that we have no sufficient basis for finding what New Jersey's offer would have been. For one reason, neither the Peabody report nor the Hyde report gave any satisfactory notion of the liquidation value of

17. This was about $11 million less than the litigation scrap model that CNJ's experts submitted for an April 1, 1976 value under the prevailing market prices for the dismantled assets and about $50 million more than the litigation scrap model submitted by the Government's experts.

> CNJ's real estate, as CNJ's expert Van Horn conceded. We cannot assume that the State would have entered into serious negotiations when one of its figures with respect to such a major item was more than 150% of the other. Perhaps there might have been a split-the-difference approach, perhaps New Jersey would have commissioned a new appraisal of the real estate, perhaps something else would have occurred—we simply do not know . . . we cannot properly award judgment on the basis of mere speculation. *CNJ has simply not met its burden of showing by clear and convincing evidence* that, after the Peabody and Hyde appraisals were available, New Jersey would have made an offer at any ascertainable figure, and we therefore need not discuss what the result should be if CNJ had carried its burden on the facts. (emphasis added)[18]

CNJ Opinion, 571 F. Supp. at 1284 (CA-689-90).

Having eschewed evidence as to how the State of New Jersey *actually perceived* CNJ's scrap values, the Court then proceeded to determine how those values *should have been perceived* by New Jersey by constructing a judicial scrap model, picking and choosing from various parts of the scrap models submitted by both parties and filling in—we contend out of "whole cloth"—perceived interstitial gaps in the materials before it. It arrived at the net liquidation valuation of $42.5 million. There is no evidence in the record that the State ever viewed or would have viewed the scrap value of the CNJ at such a low level or that CNJ would have agreed to dispose of its rail assets for so little.

CNJ contends that the Special Court erred in substituting its own judgment as to scrap values for those actually held by the parties in interest and that it committed numerous errors in the course of constructing its judicial scrap model. However, the central issues raised on this appeal do not turn upon whether the Special Court properly interpreted or applied the words "net liquidation value" as used in Section 306(c) of the Rail Act. The

18. The words italicised here as well as in the quotation at page 11 above demonstrate the unduly strict standard of proof to which CNJ's evidence was subjected.

basic issue on the appeal concerns constitutional entitlement and whether the scrap valuation derived satisfies the requirements of the just compensation clause of the Fifth Amendment.

Section 303(c) of the Rail Act entrusts the Special Court with the obligation of determining whether the certificates of value to be issued under Section 306 of the Rail Act satisfy the constitutional minimum which CNJ is entitled to receive for the taking of its assets.[19] We contend they do not in three respects. First, the scrap valuation made of the conveyed assets does not adequately measure in the constitutional sense the value of an operating rail system taken for continued rail use. Second, the certificates of value, being a debt obligation of the United States, accruing interest at only 8%, compounded annually, is a constitutionally inadequate form of compensation because their present market value is approximately 15% less than their face value and because they inadequately measure the delay damages CNJ has suffered since 1976 by virtue of being deprived of the value of the property taken. Third, the certificates of value do not compensate at all for the severance damage caused to CNJ's ownership of the Newark Bay Bridge which was excluded from the mandated conveyances.

The Special Court addressed the form of the compensation as well as the constitutional valuation standard prior to the submission of any evidence. On the former, it sustained the form of the compensation provided by the Rail Act, holding that payment in cash was not a constitutional requirement. *CMV Opinion*, 445 F. Supp. at 999-1004 (CA-167-76). As for the latter, it determined that, at least initially, market value should be viewed as the measure of just compensation, subject to the caveat that an alternative standard—such as one related to depreciated original cost—might be used if market values were too difficult to prove or

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19. The controlling test in Section 303(c) is whether the transfers were "fair and equitable . . . in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under Section 77 of the Bankruptcy Act". The Special Court interpreted the test as meaning whether the compensation satisfied constitutional minimum standards under the Fifth Amendment. *Severance/Delay Damage Opinion*, slip op. at 4-6 (CA-817-19).

led to an unfair result. *Id.* at 1029-31 (CA-226-30). The Court went on to note that it "would not be surprised to find that revised market value figures were not much different from depreciated original cost."[20] *Id.* at 1031 (CA-230).

The Court in the same opinion rejected the relevance of a variety of other measures of value, and noted the Government had been unable

> to produce a single decision in which a losing public utility being taken for continued use was valued as scrap and the opinions convey a sense that such a solution would be unacceptable, at least if scrap value were negligible.

CMV Opinion, 445 F. Supp. at 1027 (CA-222-23).[21] Notwithstanding this, the Special Court concluded almost *sub silencio* in the course of processing the case through its various phases that it was appropriate, in the constitutional sense, to limit CNJ's just compensation to scrap values assessed in artificial glutted markets that, it was assumed, might exist if the Rail Act had not been enacted and all transferors would have been scrambling at the same time to dispose of all their assets. The Court held that the net liquidation value it found under § 306(c) of the Rail Act met just compensation standards. *In re Valuation Proceedings Under §§ 303(c) and 306 of the Regional Rail Reorganization Act of 1973*, Misc. No. 76-1, slip op. at 8 (Regional Rail Reorg. Ct. Dec. 5, 1984) (CA-812). We contend this was error for the reasons set forth in the following section of this Statement.

The remaining major issues were decided by the Special Court in its opinion of June 15, 1984. CNJ had contended that, under Section 303(c)(2)(C) of the Rail Act, 45 U.S.C. § 743(c)(2)(C), a supplemental judgment should be entered against Conrail awarding CNJ an amount of delay damages equal to the difference between the amount of interest accruing on the certificates of value at their statutory rate of 8%, compounded annually, and the amount that would be payable if the interest accrued during the delay period at market rates for conservative debt securities, such as the average annual rates prevailing on long term, corporate bonds rated Aaa, compounded

20. CNJ's evidence shows that the depreciated original cost of its conveyed assets was $63.3 million, exclusive of assets transferred by any of its affiliated companies.

21. The Special Court recognized that the *New Haven Inclusion Cases*, 399 U.S. 392 (1970), "do not qualify for this role", *CMV Opinion*, 445 F. Supp. at 1027 n.42 (CA-222), since the parties to the transaction had agreed upon the use of liquidation values as the basis for valuing the properties being transferred.

annually. The difference using such a measure approximates $22 million for the period April 1, 1976-June 30, 1984 and threatens to continue to grow dramatically through December 31, 1987 in view of the high current interest rate levels.[22] CNJ also contended that the supplemental judgment should direct Conrail to reimburse CNJ for severance damages in the form of expenses to be incurred in removing the Newark Bay Bridge. The Government has estimated that approximately $14 million in such expenses will be required to remove the Bridge.

The Special Court in the *Severance/Delay Damage Opinion* determined that the statutory rate was adequate in light of the interest rates on eleven year government obligations prevailing at the time of the taking and the deference to be given to the Congressional determination to use this rate in addressing the Northeast rail crisis. The Special Court also rejected the claim for severance damages on the ground that the injury was not cognizable as severance damages and because, it found, that CNJ would have borne the expenses in the absence of the Act.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

The within appeals present substantial questions of constitutional right, some of broad public applicability and significance, concerning the proper components and measurement of the just compensation to be paid in a taking of a utility's assets for continued use. Prior to the passage of the Rail Act, CNJ and other railroads had been compelled to provide uneconomic service to commuters and light density line freight users and to operate under other obsolete regulatory restraints which suppressed their earning power. CNJ sought regulatory relief of many types in various forums.[23] The relief ultimately came (*see*, for example, in addition to the provisions of the Rail Act concerning abandonment and subsidies for commutation and light density freight service, 45 U.S.C. § 744, the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210, 90 Stat. 33 (1976)

22. The difference would be substantial no matter which index (including those limited to government securities) is selected to measure conservative investment returns during the period of delay.

23. *See*, for example, those cited at page 4 as well as Contract Service Charges Between New Jersey Points, ICC I&S Docket No. 8702 (light density branch subsidies); Application for Authority to Use Certain Terminal Facilities, filed December 13, 1972, ICC Finance Docket 27265 (major consolidation proposal for Northern New Jersey); *In the Matter of Proposed Increase Central R.R.*, 125 N.J. Super. 48, 308 A.2d 370 (App. Div. 1973), *aff'd*, 66 N.J. 12, 327 A.2d 427 (1974) (denial of intrastate freight rate increase).

(codified as amended in scattered sections of 45 U.S.C. and 49 U.S.C.), the Bankruptcy Code 11 U.S.C. § 1170 and the Staggers Rail Act of 1980, Pub. L. 96-448, 94 Stat. 1898 (1980) (codified as amended in scattered sections of 49 U.S.C.), but too late to benefit CNJ.[24] The government, having suppressed the value of CNJ's assets, now seeks to take those assets, valued as "scrap" in artificial markets, to be used and disposed of for its benefit in a substantially ameliorated regulatory environment. This is fundamentally unfair. See *In re City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y.2d 212, 220-21, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966), *appeal dismissed sub nom. Fifth Avenue Coach Lines, Inc.* v. *City of New York*, 386 U.S. 778 (1967).

CNJ opposed the passage of the Act and its "reorganization" under it. It wanted to work out its own destiny; but most of its rail assets were taken under the Rail Act on April 1, 1976, leaving it with bits and pieces of retained property[25] and a bridge rendered useless by the taking and subject to a potential removal liability estimated at $14 million. No compensation was paid to CNJ on April 1, 1976. It has now been determined that the scrap value of the assets transferred is $42.5 million and that CNJ should receive government obligations in that face amount, bearing 8% interest, compounded annually from April 1, 1976 and redeemable no later than December 31, 1987. Because the 8% statutory rate has itself been rendered obsolete by the explosion in interest rates since 1976, the rate does not fairly measure the investment opportunities lost in the past 8 years; and it reduces the present worth of the certificates of value given in exchange for the assets.[26]

24. The impact of the more flexible regulatory climate now prevailing is evidenced by the favorable operating results of Conrail from a system comprised of lines of bankrupt carriers.

25. CNJ has realized over $20 million in cash from the partial disposition of these properties.

26. Federal obligations paying 8% interest and maturing in early 1988 were selling in the market place at about 85% of face value at the time of the Special Court's determination.

These facts raise substantial constitutional questions under the just compensation clause of the Fifth Amendment as to the valuation standard for the assets taken, the form of compensation and its adequacy to reimburse for the delay damages, and as to whether severance damages should be paid for the costs of the removal of the bridge. The answers provided by the Special Court to these questions were unprecedented and, we contend, unfair in the constitutional sense. It has held that the just compensation to be paid for a railroad taken for continued use (1) can be measured by scrap values; (2) need not be in cash nor in an amount sufficient to compensate for the lost investment opportunities during the period of delay; and (3) should not compensate for diminution in value to retained property rendered useless and converted to a liability by the taking.

A. THE QUESTION OF THE VALUATION STANDARD

CNJ will argue on these appeals that the scrap value of an operating rail system taken for continued rail use can never provide just compensation for that taking. There are two reasons for this. The first is that a scrap value standard fails to compensate for, and, in fact, penalizes the condemnee, for the values transferred, which is the lodestar of just compensation. *Kimball Laundry Co.* v. *United States*, 338 U.S. 1 (1949). The basic premise of all scrap valuations—i.e., the dismantlement and piecemeal disposition of the facility—is both unrealistic and irrelevant to the taking; and it deprives the owner of the value of his property for its highest and best use. The railroad is not going to be dismantled. The taking is not of piles of scrap and multiple, unrelated, parcels of real estate with their grades and cuts restored to natural levels; for the assets transferred were part of and will continue to be used as a going rail system.

> It involves a practical contradiction of terms to say that property useful and actually used in public service is not to be estimated as having the value of property in use, but is to be reckoned with on the basis of its 'junk value'.

City of Denver v. *Denver Union Water Co.*, 246 U.S. 178, 191 (1918). Scrap valuations not only fail to recognize any increments of value for the development of the integrated rail system which is transferred but also penalize the condemnee for the central elements of the values transferred by including deductions for costs presumed to be required to disassemble the properties and to restore them to their natural state. *See supra* pp. 9-10. The scrap valuation results in the condemnor receiving the assembled system for less than even the market price of the dismantled components. Yet, the taking was of a railroad for use as such; and the compensation to be "just" should reflect this fact and not be based upon a "junk" hypothesis.[27]

The second reason why a scrap valuation cannot produce a proper measurement of just compensation is that a number of deductions taken in the process of scrap modeling are inconsistent with principles of just compensation. For example, all scrap valuations take deductions for the expenses of selling and liquidating the properties; but such selling and liquidating expenses are never taken into consideration in determining the just compensation to be paid for property taken. When property is taken in the routine case, its fair market value is not reduced by selling commissions or other holding or disposition costs. Similarly, scrap value studies generally reduce real estate values by some factor thought appropriate to reflect reversionary interests in the title which are assumed to mature in a hypothetical liquidation.

27. This junk hypothesis cannot be justified here as the answer to the famous question of Justice Holmes of "what has the owner lost . . ." *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910). CNJ was not a venture seeking to liquidate as in *Market Street Ry. Co.* v. *Railroad Comm'n of California*, 324 U.S. 548 (1945) but a rail system committed to remaining in business with alternatives that it wished to pursue. It thought, before consideration of the Rail Act began, that its profitability could be restored; and there was unrebutted evidence below which suggested that such profitable results could have occurred if it were relieved of uncompensated passenger losses. The Special Court, without any evidence that CNJ intended, or was about, to be liquidated, prejudged the answer to Justice Holmes in directing that CNJ prove a disposition of its properties under the most unfavorable circumstances and equating the result to just compensation. What the CNJ lost was a rail system with a variety of favorable opportunities for which account was not taken.

However, eminent domain cases routinely ignore remote reverters, recognizing that to do otherwise is both to unfairly penalize the condemnee (since the reverter is remote) and to provide a windfall to the government (since it will pay nothing to the holder of the reverter). *Terminal Coal Co.* v. *United States*, 172 F.2d 113 (3d Cir. 1949); *United States* v. *635.76 Acres of Land*, 319 F. Supp. 763 (W.D. Ark. 1970), *aff'd per curiam*, 447 F.2d 1405 (8th Cir. 1971); *Santa Monica* v. *Jones*, 104 Cal. App. 2d 463, 232 P.2d 55 (1951); *Restatement of Property* § 53, Comment b (1936). Finally, and very important in the present case, some scrap studies apply a discounted cash methodology in determining sales proceeds by projecting sales proceeds as well as holding costs (such as taxes and insurance) over the period of the hypothetical liquidation and then discounting the value of such elements back to the taking date by an appropriate discount factor. Such a methodology was used with the consent of the parties in the New Haven litigation. *See supra* note 21. There is a split among railroad appraisers as to the appropriateness and feasibility of this practice; but the Special Court adopted it below. Regardless of whether this was permissible in determining the Section 306 standard of "net liquidation value", CNJ contends it was improper to do so in determining the constitutional issue of just compensation because holding costs, difficulties of sale, and the potential delays in receipt of proceeds were all taken into account by the appraisers in providing the opinions as to the fair market value of the separate parcels which was the beginning point of the valuation process. In effect, superimposing the discount methodology upon the appraisal process involved a double counting of the detriments of the property and thereby improperly reduced its net value to the extent of the double count.

The modeling of the results of the hypothetical scrapping process is not an uncommon exercise in the railroad business and leads to one measure of value to be considered with others in arriving at a fair valuation of railroad assets. It is, however, exceedingly uncommon to adopt a scrap valuation standard in determining the just compensation for assets taken for continued

use. Neither the Special Court nor, as it noted, the government parties, were able to find a single case in which such a measure has ever before been held to be constitutionally sufficient. The authorities and commentators have been uniformly of the belief that it is not.[28] The case of *In re Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968), which required a substantial payment for the public acquisition of tunnels with a negative scrap value, has previously been referred to by this Court as an appropriate instance of recognizing the condemnee's entitlement to the highest and best use of its property. *New Haven Inclusion*

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28. *See*, in the area of utilities valuation: *City of Denver* v. *Denver Union Water Co.*, 246 U.S. 178 (1918); *In re City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966), *appeal dismissed sub nom. Fifth Avenue Coach Lines, Inc.* v. *City of New York*, 386 U.S. 778 (1967); *In the Matter of Penn Central Transportation Co.*, 372 F. Supp. 1123 (E.D. Pa. 1974); *Trustees of Boston & Maine Corp.* v. *Massachusetts Bay Transp. Authority*, 294 N.E.2d 340 (Mass. 1973); *In re Aldercroft Heights City Water Dis.*, 60 P.U.R.3d 227 (Cal. Pub. Util. Comm'n 1965); *In re Fair Oaks Irrigation District*, P.U.R. 1918C, 879 (Cal. R.R. Comm'n 1918); *In re City of Washburn*, P.U.R. 1924D, 368 (Wis. R.R. Comm'n 1924); *In re City of Eureka*, 19 Cal. R.C.D. 952 (1922); *International Railway Co.* v. *Niagara Parks Commission*, 3 D.L.R. 305 (P.C. 1937); *In re Ottawa and Glouchester Road Co. and County of Carleton*, 69 D.L.R. 486 (Ont. Sup. Ct., App. Div. 1921); *see also* the additional cases cited and discussion in R.L. Hale, *Value to the Taker in Condemnation Cases*, 31 Colum. L. Rev. 1 (1931); Comment, *Valuing an Unprofitable Business Taken for Continuing Public Use*, 68 Colum. L. Rev. 977 (1968); Note, *Going Concern Value in Condemnation of Unprofitable Public Utilities*, 52 Cornell L.Q. 752 (1967); 2 Orgel, *Valuation Under Eminent Domain* § 217 (2d ed. 1953); *see also* the patent condemnation cases such as *Olsson* v. *United States*, 25 F. Supp. 495 (Ct. Cl. 1938), *cert. denied*, 307 U.S. 621 (1939); *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *rev'd in part on other grounds*, 320 U.S. 1 (1943); *Badowski* v. *United States*, 278 F.2d 934 (Ct. Cl. 1960); *Saulnier* v. *United States*, 314 F.2d 950 (Ct. Cl. 1963); *Ushakoff* v. *United States*, 375 F.2d 822 (Ct. Cl. 1967); *Tektronix Inc.* v. *United States*, 552 F.2d 343 (Ct. Cl. 1977), *cert. denied*, 439 U.S. 1048 (1978) and *see also* the wartime takings cases, *United States* v. *Buxton Lines, Inc.*, 165 F.2d 993 (4th Cir. 1948); *Swiss Federal Railways v. United States*, 112 F. Supp. 357 (Ct. Cl. 1953); *Wilson Athletic Goods Mfg. Co.* v. *United States*, 161 F.2d 915 (7th Cir. 1947).

Cases, 399 U.S. at 451-58[29]. The determination of the Special Court below presents a radical departure in the law. It is wrong as a matter of principle; and it results in a standard which unjustly tilts the balance between the government and private rights in favor of the government.

Nor can the Special Court's result be justified upon the theory that the scrap value model it created reflects the market value of the properties. A market value inquiry is a search for *what was in fact obtainable* for the properties in the appropriate market and not an occasion to superimpose upon real world judgments the normative opinions of a court as to *what should be obtainable* under hypothetical circumstances that have never existed. The Special Court has awarded the latter, not the former.

The Special Court did not award the market value of CNJ's transferred assets, *i.e.*, what a willing buyer would pay a willing seller if neither were under any compulsion to buy or sell. It was presented with extensive evidence of the State of New Jersey's 1974 purchase negotiations with the CNJ (consisting of contemporaneous documents and the testimony of the many persons involved in the negotiations) as well as of the State's perceptions of the scrap value of the transferred assets (consisting of its three extensive studies, *see supra* p. 6). It rejected this evidence (without ever observing the demeanor of a single witness) under improper standards of proof; finding that "it is *far from certain* that the State would have actually carried out such a project", *Rail Use Opinion*, 531 F. Supp. at 1377 (CA-575) and that CNJ

29. As the *New Haven* case recognizes, it is no answer to say that such use can be disregarded because it is unprofitable in the hands of its present owner. An industrial plant may be operating at a loss for many reasons having nothing to do with the suitability of the property for industrial use. Such a plant still has value as an industrial property in the market place so long as demand exists for such use. There is no doubt that the services provided by the CNJ system were not only in demand but regarded as essential, *see supra* p. 4, and under its present owner these and other formerly unprofitable rail operations have become highly profitable. The Special Court's focus on the circumstances, or more accurately the hypothetical circumstances, of the property owner led to an idiosyncratic valuation having little relation to the values transferred or the highest and best use of the property.

had not met "its burden of proof by *clear and convincing evidence*", *CNJ Opinion*, 571 F. Supp. at 1284 (CA-690) that New Jersey would have made an offer at any ascertainable figure. It determined that "for one reason, or another the minds of all concerned in 1974 were attuned to a higher scale", *id.* (CA-689) and concluded to measure CNJ's constitutional entitlement by substituting for this real world evidence its own version of a forced sale, scrap model formulated under the hypothetical, *a priori* assumption that all transferors would be seeking to dispose of their properties at the same time.[30]

The scrap valuations found by the Special Court do not reflect the market values of the transferred assets in a sale for scrap on the taking date. In fact, they do not reflect the scrap values that have ever prevailed on any date in the real world. On April 1, 1976, the date of the taking, there were real markets in which the assets transferred could have been sold on a dismantled basis and those markets included within them the potential availability of over 3000 miles of line which the Final System Plan prepared by USRA pursuant to the Rail Act concluded to leave with the estates, leaving them to obtain their value by alternative dispositions for scrap or otherwise. CNJ's evidence on scrap values priced the transferred assets in those real world markets which reflected the significant increases in potential supply created by the Rail Act. The Court rejected reference to those real markets in fashioning its own scrap model, pricing the assets in markets hypothetically glutted by even more of the assets of the other transferors.[31] In treating the assets of the other condemnees as

30. The scrap model fashioned by the Court in the *CNJ Opinion* differs widely not only in result but in methodology from the various studies available to the State in 1974. *See supra* p. 6. The wide variance in methodology demonstrates that the Court's results do not even purport to reflect how the State, or CNJ, actually viewed the scrap value of the properties. (These studies, which are in the record below, are lengthy; pertinent portions will be submitted with the brief on the merits if plenary consideration is granted to these appeals.)

31. One of the evils of the methodology adopted by the Court—*i.e.*, converting a factual inquiry as to market values into a normative judicial model under hypothetical assumptions—is that literally anything could be "found" which would support any pre-determined end result and be difficult to review. We will argue on appeal that, in addition to

part of the relevant market, the Court may have infringed upon the controlling principles of *Almota Farmers E. & W. Co. v. United States*, 409 U.S. 470 (1973); and it substituted speculative valuation conclusions, often unsupported by any proofs, for the valuations derived from real world market data. The Special Court's scrap model, having failed to measure the fair market values prevailing at the time of the taking realizable from a scrapping process, cannot be a proper measure of just compensation even if scrap values were the controlling standard.

Nor does the Special Court's scrap value result reflect the fair market value of the rail assets for continued rail use. There was no evidence that the Trustee or the estate would have been a willing seller at the prices found by the Court. There was no evidence that the State (or even any scrap dealer) viewed the property as having so little scrap value or that Commissioner Sagner ever sought to purchase it at such a low price. Instead the evidence is, as the Court found, that "the minds of all concerned [the negotiators and the many valuation experts who had valued the property] were attuned to a higher scale". *CNJ Opinion*, 571 F. Supp. at 1284 (CA-689). All the evidence as to what had actually occurred suggests that the property would have sold for at least twice the Special Court's valuation.

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the flaws noted in the text, the model created by the Court arbitrarily (a) rejected CNJ's real estate appraisal evidence under a clearly erroneous view of certain appraisal assumptions concerning rail service and topography in favor of preliminary, incomplete, penciled notations on prior appraisal worksheets (which utilized the same assumptions as CNJ's rejected appraisal evidence in the areas faulted by the Court) prepared for different and inapplicable purposes, which were then adjusted by the Court, (b) rejected 1976 equipment valuations of appraisers of both parties in favor of a lower 1968 study, (c) rejected 1976 assessments of appraisers of both parties as to the value of ties in favor of an erroneous inapplicable opinion reached by a former employee of one of CNJ's appraisers, (d) rejected substantial evidence of the marketability of light rail in favor of an unsubstantiated contrary opinion, and (e) applied and adjusted the basic concepts of a liquidation organization formulated for a 1968 appraisal which the appraiser involved demonstrated had no applicability to the circumstances posed by the valuation proceeding.

The Special Court brought to the valuation case a preconceived view which underestimated the value of the assets of the Northeastern railroads, for it had stated in its 1974 opinion in *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 917 "the idea that billions of dollars in liquidation proceeds of these bankrupt railroads are lurking just around the corner is unrealistic in the last degree." This view was uninformed, when formulated; and it infected the subsequent valuation proceedings that followed. We seek the opportunity to demonstrate at plenary hearing that the hypothetical scrap valuations derived from the court's judicial model do not measure the market value of the assets taken from CNJ or the just compensation to which CNJ is entitled.

B. THE QUESTIONS OF THE FORM OF COMPENSATION AND DELAY DAMAGES

The Special Court held that the certificates of value authorized by Section 306 of the Rail Act were a constitutionally sufficient form of consideration for the assets taken and adequately compensated for the delay damages CNJ has incurred since 1976 and may incur until December 31, 1987 when the certificates must be redeemed.[32] It held in the CMV opinion that the constitution does not require payment in cash for a taking, *CMV Opinion*, 445 F. Supp. at 1003-04 (CA-176). A number of other courts have held to the contrary. *See, Vanhorne's Lessee* v. *Dorrance*, 2 Dall. 304 (Cir. Ct. Pa. Dist. 1795); *Butler* v. *Sewer Commissioners*, 39 N.J.L. 665 (N.J. Sup. Ct. 1877); *Commonwealth* v. *Peters*, 2 Mass. 125 (1806); *Reynolds* v. *State Board of Public Roads*, 59 R.I. 120, 194 A. 535 (1937); *cf. State* v. *Dunclick, Inc.*, 77 Idaho 45, 286 P.2d 1112 (1955); *Connecticut River R.R.* v. *Franklin County Comm'r*, 127 Mass. 50 (1879); *Hamilton* v. *Annapolis, etc., R. Company*, 1 Johnson 107, (Md. Ch. 1847), *aff'd*, 1 Md. 553 (1852); *Bloodgood* v. *M. & H. R.R. Co.*, 18 Wend. 1 (N.Y.

32. The Court assumed that the certificates of value would be redeemed at an earlier point *Severance/Delay Damage Opinion*, slip op. at n.8 (CA-829, 857-58), but the government is not obliged to do so and has never stated that it would.

Ct. Err. 1837). This Court specifically reserved the question in the *Rail Act Cases*, 419 U.S. at 51-52.

Whether it is constitutionally permissible to use government obligations as just compensation is interwined in the present matter with the question of the sufficiency of the interest rate provided for the certificate of value in Section 306. Government obligations bearing 8% interest with early 1988 maturities are presently trading at a large discount with the consequence that the certificates of value issued to CNJ are worth considerably less than the amount it is entitled to receive. It is hard to see how this satisfies the requirement of the Fifth Amendment that the owner receive "a full and perfect equivalent for the property taken . . ." *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 326 (1893). The problem with the 8% interest rate, however, goes much further; for it emphasizes the inadequacy of the compensation to cover CNJ's delay damages.

It is well settled that, where there is a delay between the time of a public taking of private assets and the time of the payment therefor, the condemnee is entitled to have included within the just compensation that is paid an amount sufficient to compensate for the losses incurred during the period of the delay. *Seaboard Air Line Ry* v. *U.S.*, 261 U.S. 299, 306 (1923); *Kirby Forest Industries, Inc.* v. *U.S.*, ____ U.S. ____, 52 U.S.L.W. 4607, 4610 (U.S. May 21, 1984). The condemnee is entitled to receive the value of the condemned assets on the date of their taking; and it is the deprivation of this value, and the earnings that could have been generated from its investment and reinvestment, that constitutes the condemnee's loss. *Id.* at 4610.

It was also well settled that the rates of return on investments in conservative debt instruments available in the marketplace during the period of delay is an appropriate measure of the delay damages, although the lower courts have disagreed as to the type of investments to consider. The Court of Claims and other courts have used as a measurement the average annual rates during the delay period on long term corporate bonds rated Aaa. *See, e.g., Pitcairn* v. *U.S.*, 547 F.2d 1106 (Ct. Cl. 1976), *cert. denied*, 434

U.S. 1051 (1978); *Miller* v. *U.S.*, 620 F.2d 812 (Ct. Cl. 1980); *U.S.* v. *97.19 Acres*, 511 F. Supp. 565 (D. Md. 1981). Some federal courts have used other measurements, such as a mixture of government, bank and commercial debt obligations, averaging rates on this composite during the period involved. *See, e.g., U.S.* v. *429.59 Acres of Land*, 612 F.2d 459 (9th Cir. 1980). Others have used yields on U.S. Government obligations of varying duration. *See, e.g., U.S.* v. *5.00 Acres*, 507 F. Supp. 589 (E.D. Tex. 1981), *rev'd on other grounds*, 680 F.2d 388 (5th Cir. 1982), *rev'd on other grounds*, 731 F.2d 1207 (5th Cir. 1984); *United States* v. *8.41 Acres of Land*, 576 F. Supp. 685 (E.D. Tex. 1983). Very little judicial attention has been devoted to whether compounding of the returns selected is constitutionally required; and those who have considered the question have differed. Compare *U.S.* v. *429.59 Acres of Land*, 612 F.2d 459 (9th Cir. 1980); *U.S.* v. *319.46 Acres of Land*, 508 F. Supp. 288 (W.D. Okla. 1981) with *Georgia-Pacific Corp.* v. *U.S.*, 640 F.2d 328 (Ct. Cl. 1980); *U.S.* v. *97.19 Acres*, 511 F. Supp. 565 (D. Md. 1981). This Court has yet to pass on any of these issues.

In the instant matter the Special Court held that the 8% compound rate provided by the Rail Act was adequate and rejected the higher rates, which at times were more than twice the statutory rate, available during the delay period on virtually all types of conservative investments.

The Special Court deferred to the statutory rate because it was in line with interest rates which prevailed at the time of the taking. *Severance/Delay Damage Opinion*, slip op. at 18-19 (CA-829). Finding the statutory rate "reasonable at the time", the Court below ruled that it would not be "set aside." *Id.* Congress itself, however, recognized the possible inadequacy of the Section 306(c)(4) compensation and provided in Section 303(c) for an upward adjustment by the Special Court if necessary to meet constitutional minimum values. The over deference of the Court below to the statutory rate not only gives inadequate weight to this statutory consideration but also slights the basic

principle that the determination of what constitutes "just compensation" under the Fifth Amendment is exclusively a matter for the courts and not the legislature. *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 327 (1893); *Miller* v. *U.S.*, 620 F.2d 812, 837 (Ct. Cl. 1980); *U.S.* v. *Blankinship*, 543 F.2d 1272 (9th Cir. 1976).[33]

The Special Court sought to justify its deference to the 8% statutory rate by viewing it as the approximate equivalent of what it considered would have been the appropriate measurement in any event—namely, the yield on a long term U.S. Government bond issued and purchased in April of 1976 and maturing at the end of 1987 which it held, would approximate the certificates of value authorized by Section 306, both in terms of interest rate and maturity. This prospective assessment of appropriate delay damages based on a single hypothetical investment made at the time of the taking ignores the basic theory of delay damages, i.e., to compensate the condemnee for the damages *actually* incurred during the period of delay, whether or not contemplated at the time of the taking. The Special Court's decision to apply the interest rates prevailing at the time of the taking in disregard of all measurements which would reflect the much higher interest rates prevailing during the delay period conflicts with most, if not nearly all, of the lower federal court rulings in recent years. *See Miller* v. *U.S.*, 620 F.2d 812, 838 (Ct. Cl. 1980) and cases cited therein. It does not and cannot effectuate the basic objective to place the condemnee in "as good a position pecuniarily" as he could have been had he gotten his money at the time of the taking. *Kirby Forest Industries, Inc.*, 52 U.S.L.W. at 4610.

CNJ, if it had been paid in cash in 1976, of course, would not have been restricted to investing in Government securities, let alone those with 11 year maturities. It would have been free to invest and reinvest with the view to realizing the highest yield or

33. Moreover, the Court's deference to the legislative determination ignored the fact that the Congress set the rate at a time when the compensation included the Conrail securities and the certificates were not expected to be the sole or even major consideration paid for the conveyed properties. H.R. Rep. No. 781, 94th Cong., 2d sess. 199 *reprinted in* 1976 U.S. Code Cong. & Ad. News 214.

yields obtainable; and the proofs showed that, exercising reasonable prudence as to the safety of principal and interest, it could have, and actually did, on its own available funds, realize yields on conservative investments during the period in question well in excess of those realizable from an 11 year Government obligation bought in 1976. This is significant—not because CNJ has, in fact, realized such yields—but rather because such yields were generally obtainable and, thus, provide an objective measure of the delay damage element of just compensation. The questions posed by the ruling below are substantial, affecting both federal and state condemnations; for the "just compensation" requirement of the Fifth Amendment for federal takings applies also to state condemnations by virtue of the Fourteenth Amendment. *Webb's Fabulous Pharmacy, Inc.* v. *Beckwith*, 449 U.S. 155, 160 (1980); *Texaco, Inc.* v. *Short*, 454 U.S. 516, 522 (1982). The opinion should be reviewed on plenary hearing.

C. THE QUESTION OF SEVERANCE DAMAGES

Pursuant to the Rail Act, the Government took nearly all of CNJ's operating rail system but excluded CNJ's Newark Bay Bridge which was an integral part of that system. With its withdrawal from rail service, the bridge was rendered essentially useless, and its value to CNJ converted to a liability, as the U.S. Coast Guard, which had viewed the bridge as a hazard to navigation, began proceedings under the Bridge Act of 1906, 33 U.S.C. § 491 *et seq.* to require its removal.

As a result of the partial taking, CNJ was left with ownership of the now useless, severed bridge and liability for the entire cost of removal, then estimated at approximately $14,000,000.[34] The overall effect upon the condemnation proceeds was potentially to reduce the Special Court's finding of approximately $42,500,000

34. While the bridge was in rail service, any required alteration or removal would have been governed by the Truman-Hobbs Act, 33 U.S.C. § 502, and the cost thereof would have had to be borne by the Government except for expenditures found of benefit to the railroad. As the Special Court noted, under Truman-Hobbs the United States would have had to bear most if not all of the cost of removal of the CNJ bridge. *Severance/Delay Damage Opinion*, slip op. at 29 (CA-838).

for the value of CNJ's rail system at April 1, 1976, to approximately $28,500,000. CNJ seeks as severance damage reimbursement for the costs it has been obligated to bear as a result of the partial taking. The Court ignored the simple fact of the change in CNJ's actual circumstances from the owner of an operating rail system, including the bridge, to the owner of an isolated unused structure which resulted from the partial taking, exposed to huge liability for the cost of its removal. Instead, the Special Court concluded that the claim did not fall within the rubric of severance damages and proffered the thesis that the CNJ bridge had really lost its value for rail use because Conrail had taken another bridge (the Penn Central-Lehigh Valley Bridge to the north) for its traffic and that CNJ's injury, therefore, did not result from the partial taking of CNJ's property. The question, however, is not why the bridge was not needed by the condemnor but what made the bridge useless to CNJ. Clearly the answer to that lies in the severance of the balance of CNJ's rail system pursuant to the statutory taking.

The Court offered an alternative ground for rejecting CNJ's severance claim, finding that CNJ would have borne the removal costs in the absence of the Act because it was seeking, or would have sought, to liquidate its assets if the Act had not rescued it from its predicament or because the State in an asset purchase would have insisted upon either not acquiring the bridge or a $14 million deduction in its purchase price if the bridge were included in the rail assets purchased. The findings flow from the *a priori* liquidation assumptions of the Special Court, are inconsistent with prior findings by the Court,[35] and stand the events that actually occurred in the real world on their head. The record establishes that prior to the passage of the Act, the trustee never sought to cease rail operations or to liquidate; that he successfully resisted efforts of others before the Reorganization Court to compel such cessation; that the Third Circuit found that the estate's progress precluded the cessation of deficit passenger operations;

35. *See*, for example, footnote 6 *supra* and the Court's prior determinations as to the assets which the State would have acquired. *Rail Use Opinion*, 531 F. Supp. at 1209, 1379 (CA-291-92, 577-79).

that the estate literally begged Congress not to pass the Act and the Special Court not to compel CNJ's reorganization under it; that on the issue of erosion, CNJ stipulated that its CUE was zero instead of asserting any maturation of a so called "Brooks-Scanlon" right;[36] that all of the purchase negotiations with the State proceeded upon the assumption that the Bridge would be included within the purchase without significant offset in the purchase price;[37] and that the decision in *In re Port Authority Trans-Hudson Corporation*, 20 N.Y.2d 457, 231 N.E. 2d 734, 285 N.Y.S. 2d 24, *cert. denied*, 390 U.S. 1002 (1968), would have precluded the State from compelling any major offset.

The implementation of the Rail Act has saddled CNJ with a major financial responsibility it would not have otherwise faced. We seek the opportunity upon appeal to demonstrate fully the foregoing and to establish that the claim that has been asserted should, as a matter of constitutional principle, be cognizable as severance damages.

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36. *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 918-19. CNJ's legal position was that the question of whether erosion exists turned on the values ultimately found for the conveyed assets. If those values were sufficient, there would be no erosion since potential interim losses from continued operations were counterbalanced by the assured minimum asset values and the probability of a value enhancing reorganization.

37. Not only was this the tenor of the negotiations; none of the valuation studies commissioned by the State contained any offsets of comparable magnitude.

CONCLUSION

For all of the foregoing reasons, this Court should note probable jurisdiction of these appeals.

Respectfully submitted,

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